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UNCLAS SECTION 01 OF 03 BANGKOK 002360

SIPDIS

SENSITIVE

STATE FOR EAP/MLS AND EB
COMMERCE FOR 4430/EAP/MAC/OKSA
TREASURY FOR OASIA
STATE PASS TO USTR FOR WEISEL
STATE PESS TO FEDERAL RESERVE FOR MATT HILDEBRANDT

E.O. 12958: N/A
TAGS: ECON EFIN PREL TH
SUBJECT: THAI ECONOMY REACTS TO POLITICAL UNCERTAINTY

REF: A. BANGKOK 1665 (POLITICAL PROBLEMS AFFECT THAI
ECONOMY)
¶B. BANGKOK 788 (THE GREAT THAKSIN ASSET SALE)

¶1. (SBU) Summary: Over the past few years, the Thai economy has weathered SARS, bird-flu, tsunami, increased competition from China and unrest in the country's south, all with only limited impact to growth. The ongoing political crisis that has gripped the country throughout this year, combined with record-high energy prices and a surprisingly strong currency, bring new challenges to continued economic strength. As we have reported (reftels), the economy has grown increasingly dependent on exports for its growth and will become even more so if the current political instability persists. End Summary.

¶2. (SBU) In a meeting with Assistant Governor for Domestic Economy of the Bank of Thailand (and key member of the monetary policy committee), Dr. Atchana Waiquamdee told us that domestic demand would grow slowly, if at all in the face of high energy prices, high consumer debt levels and increasing interest rates. Because of increased salaries (5-10 percent varying by sector) and continued low (1.7 percent) unemployment, there has been no increase in consumer debt defaults and spending on non-durables remains strong even as consumer confidence continues to slide. This decline in consumer confidence is reflected in slowdowns in first quarter 2006 new home sales (exacerbated by a 50 percent decline in bank mortgage approvals as banks have tightened lending standards in anticipation of weaker economic growth), new car sales and sales of other consumer durables all lead to a general consensus among Thai economists that consumers will not be a factor in the growth of the Thai economy in ¶2006. Most observers expect consumer demand to grow only at the rate of the overall economy (3.5-5.5 percent), at best as consumers continue to use -and borrow on- their credit cards to keep non-durables spending near current levels. Dr. Atchana also pointedly said that the government should never have expected economic growth to come from domestic consumption given GDP/capita is only about US$2000. Comment: This is a dig at the Thaksin administration's "dual-track" economic policy which emphasized increased domestic consumption alongside export growth. One of several anti-Thaksin comments she made to us. End comment.

Government Spending Slow

¶3. (SBU) Dr. Atchana believes that, because of the caretaker status of the current government and the likelihood that political instability will persist for some months, government disbursements for capital investment will be a bit slow (80 percent of target in the first quarter) even though spending should remain on track through the remainder of the fiscal year (ending September 30). If political instability persists, however, there may be no new budget in place for the new fiscal year. In any case, in April the government announced that the much-anticipated tenders for infrastructure "megaprojects" would be delayed until a new government is in office. These projects were expected to add 0.5-1 percent to GDP and help stimulate private investment. Anecdotally, several businesses have said that government decision making has been slowed considerably because of the administration's caretaker status. As a result, there are many procurement decisions that remain on hold.

Companies Keep the Money in Their Pockets

¶4. (SBU) Private investment continues at a slow pace despite continued high capacity utilization rates (in excess of 73 percent). Foreign companies that use Thailand as an export base, especially in the auto and electronics sectors, have added capacity over the past year (a major factor in increased Thai exports--see para 5). Thai companies, however, continue their hesitancy to take on debt or spend much of their cash flow on new capacity. This is reflected in very slow bank corporate loan growth (1-2 percent). Dr.

Atchana guessed that Thai exporters are able to increase output by running multiple shifts (a factor not captured in capacity utilization figures). First quarter private investment grew at a 5.4 percent annual rate, and much of this was investment by foreign companies and foreigners buying Thai property. Further evidence of slow investment rates are seen from March imports which increased by only 1.3 percent from last year, mostly because of higher oil prices. Imports of steel and machinery declined sharply, suggesting a slowdown in capital investment.

Export Sector Saves the Day, Again

¶5. (SBU) With public and private spending and investment all in stasis, it has been the export sector that has driven Thailand's growth. Exports increased 17.3 percent in the first quarter, including a 20 percent increase in exports to the US market in March and a double-digit increase in exports to Japan. Further helping the export figures, Thai commodities including sugar, rice, tapioca and rubber, have all benefited from increases in global prices and a recovery in output after the drought of 2005. With exports comprising more than 60 percent of GDP, the continued health of this sector can maintain Thailand's general economic health.

¶6. (SBU) The improved trade balance and continued positive portfolio investment flows combined with a generally weak US$ has caused the baht to appreciate 7.3 percent against the dollar so far this year. While the Indonesian rupiah has appreciated at a similar rate, other regional currencies whose products compete with Thai exports such as the Korean won, Phillipine peso, Singapore dollar and Malaysian ringgit have increased by 4.7, 3.3, 3.0 and 2.8 percent respectively. This has created considerable apprehension among Thai business and government officials who fear that Thailand will lose competitiveness in export markets. 80 percent of Thai foreign trade is conducted in US$ and our contacts tell us that Thai exporters do not hedge their US$ income streams. Combined with increased labor, energy and interest rate costs, Thai company margins will be considerably squeezed if the baht remains so strong.

Bank of Thailand Allows Strong Baht

¶7. (SBU) The Thai Ministers of Finance and Commence have both told the press that the baht is too strong and should be targeted at a rate of about 39/US$ (current rate is just below 38/US$). Dr. Atchana advised us that the Bank of Thailand has not made much effort to prevent the baht run-up and implied that it would be unlikely to do so in the future as "the Bank does not have a policy to promote the export sector", especially since "intervention is effective for only a limited period." She also noted that the cost of intervention is increasing because, in order to keep inflation down as the money supply has increased from the inflow of fx, the Bank has had to sterilize the baht created when it buys US$ and therefore issued bonds which, in a rising interest rate environment, is an expensive operation. There is also the problem of adding liquidity when the BoT has been trying to reign in inflation. One analyst posits that "the BoT is less (not more) likely to intervene and will allow the baht to appreciate in accordance with market forces." As an aside, Dr. Atchana noted that when Temasek was remitting funds to pay for its purchase of Shin Corp, the BoT was completely out of the market, allowing the baht to rise, at least in part because the Bank "saw no reason to allow the PM's family to earn more baht because of any action from the Bank."

¶8. (SBU) Comment. In the wake of inconclusive elections in April, the political situation remains uncertain. Reftel A notes the many analysts and businesspeople who expressed concern for the economy if the political situation did not stabilize by June. Dr. Atchana told us she thought that domestic consumption and investment could actually begin to decline if Thai politics did not stabilize within three months. If this consensus proves correct, Thailand would become even more reliant on its one remaining economic engine, and that sector is under pressure from the strong baht and rising operating expenses. The Thai economic forecast for the rest of the year depends largely on the global economy maintaining its current momentum and the Thai political scene achieving some sort of clarity. The good news is that business and government debt levels are low and bank liquidity is ample, so there is some general flexibility in the system. The question is how long an economy can function without any economic policy-making from government.
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